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Summaries of and Responses to Public Comments on the Proposed Uniform Multifamily Regulations and Proposed Amendments to Regulations for the Multifamily Housing Program, Joe Serna Junior Farmworker Housing Grant Program, and the HOME Investment Partnerships Program

California Code of Regulations, Title 25, Division 1, Chapter 7, Subchapter 3
California Code of Regulations, Title 25, Division 1, Chapter 7, Subchapter 4
California Code of Regulations, Title 25, Division 1, Chapter 7, Subchapter 17
California Code of Regulations, Title 25, Division 1, Chapter 7, Subchapter 19

On May 9, 2003, the Department of Housing and Community Development (hereinafter "HCD" or "Department") released for public comment proposed regulations governing the state's Multifamily Housing Program (MHP), Joe Serna Junior Farmworker Housing Grant Program and HOME Investment Partnerships Program.

Comments were received during the public comment period, which was May 9, 2003, through June 23, 2003. Public hearings were held in San Francisco (May 22, 2003), San Diego (May 27, 2003), Los Angeles (May 28, 2003), Fresno (June 16, 2003), and Sacramento (June 23, 2003). The Department received verbal comments at the public hearings or comments in writing from the following commenters:

1. Ajit Mithaiwgla, Advanced Development & Investment, Inc., 5939 Monterey Street, Los Angeles, CA, 90042, 323-254-3338
2. Lee Novak, AF Evans Company, Inc., 100 Bush Street, Suite 925, San Francisco, CA, 94104, 415-393-5250
3. The Honorable Rebecca Cohn, Assembly, California Legislature, P.O. Box 942849, Sacramento, CA, 94249, 408-369-8170
4. The Honorable Joe Simitian, Assembly, California Legislature, 160 Town & Country Village, Palo Alto, CA, 94301, 650-688-6330
5. Carol S. Hood, California Department of Mental Health, 1600 9th Street, Sacramento, CA, 95814, 916-653-3975
6. Barbara Mitchell, California Mental Health Planning Council, 1600 9th Street, Room 350, Sacramento, CA, 95814, 916-654-3585
7. Beverly Whitcomb, California Mental Health Planning Council, 1600 9th Street, Room 350, Sacramento, CA, 95814, 916-654-3585
8. Tracey Chew, Catholic Charities, 2625 Zanker Road, San Jose, CA, 95134, 408-468-0100
9. Chris Block, Charities Housing Development Corporation, 465 S. First Street, San Jose, CA, 95113, 408-282-1125

10. Robert S. Sronce, City of Citrus Heights, 6237 Fountain Square Drive, Citrus Heights, CA, 95621, 916-727-4905
11. Beth Stochl, City of Long Beach, Housing Services Bureau, 110 Pine Ave., Ste 1200, Long Beach, CA, 90802, 562-570-6949
12. Roy Schweyer, City of Oakland, 250 Frank H. Ogawa Plaza, Suite 5313, Oakland, CA, 94612, 510-238-3501
13. Joan Ling, Community Corporation of Santa Monica, 1423 Second Street, Suite B, Santa Monica, CA, 90401, 310-394-8487
14. Joel Rubenzahl, Community Economics, Inc., 538 9th Street, Suite 200, Oakland, CA, 94607, 510-832-8300
15. Alice Talcott, Community Economics, Inc., 538 9th Street, Suite 200, Oakland, CA, 94607, 510-832-8300
16. Hector P. Burgos, Jr., Community Housing Improvement Systems and Planning Association, 295 Main Street, Suite 100, Salinas, CA, 93901, 831-757-6251 x132
17. Paul Ainger, Community Housing Opportunity Corporation, 1490 Drew Avenue, Suite 206, Davis, CA, 95616, 530-757-4444 x225
18. Maryann Leshin, Corporation for Supportive Housing, 1330 Broadway, Suite 601, Oakland, CA, 94612, 510-251-1910 x205
19. Paula Burrier-Lund, County of Orange, Housing and Community Development Department, 1770 N. Broadway, Santa Ana, CA, 92706, 714-480-2805
20. Barry Del Buono, Emergency Housing Consortium, 2011 Little Orchard Street, San Jose, CA, 95125, 408-294-2100
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22. Christopher Mohr, Housing Leadership Council of San Mateo County, 690 Broadway, Redwood City, CA, 94063, 650-364-4576
23. Judith Gaither, Human Investment Project for Housing, 364 South Railroad Avenue, San Mateo, CA, 94401, 650-348-6660
24. Robert N. Klein, II, Klein Financial Corporation, 550 California Avenue, Suite 330, Palo Alto, CA, 94306, 650-833-0100
25. David Schnur, Mid-Peninsula Housing Coalition, 658 Bair Island Road, Suite 300, Redwood City, CA, 94063, 650-482-5515
26. Fran Wagstaff, Mid-Peninsula Housing Coalition, 658 Bair Island Road, Suite 300, Redwood City, CA, 94063, 650-482-5510
27. Nancy B. Lewis, Nancy Lewis Associates, Inc., 3306 Club Drive, Los Angeles, CA, 90064, 310-204-2358
28. Dianne J. Spaulding, Non-Profit Housing Association of Northern California, 369 Pine St., Suite 350, San Francisco, CA, 94104, 415-989-8160
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31. Beverly Fretz-Brown, Sacramento Housing and Redevelopment Agency, 630 I Street, 3rd Floor, Sacramento, CA, 95814, 916-440-1347
32. Tom Scott, San Diego Housing Federation, 450 B Street, Suite 1010, San Diego, CA, 92101, 619-239-6693
33. Peter N. Carey, Self-Help Enterprises, P.O. Box 6520, Visalia, CA, 93290, 559-651-1000

34. Lisa Chin, Service Employees International Union, 1007 7th Street, Sacramento, CA, 95814, 916-442-3838
35. Eleanor Prouty, Service Employees International Union, 7901 Oakport Street, Suite 4900, Oakland, CA, 94621, 510-568-2500 x24
36. Dennis McCray, Solano Affordable Housing Foundation, 2750 North Texas Street, Suite 300, Fairfield, CA, 94533, 707-422-5919
37. Dennis Lalor, South County Housing, 7455 Carmel Street, Gilroy, CA, 95020, 408-842-9181
38. W.J. Sowa, Sowa, 3416 Kevin Court, Sacramento, CA, 95821
39. Tawnya Falkner, Strategic Development Solutions, 201 S. Barrington Ave., #320, Los Angeles, CA, 90025, 310-914-5333
40. Joshua Wilmoth, Thomas Safran & Associates, 11812 San Vicente Blvd., Suite 600, Los Angeles, CA, 90049, 310-820-4888

Following are the summaries of and responses to public comments regarding the proposed regulations.

Section 7301(i)

Comment: Revise the legal definition for *disabled household* to include changing the language "suffers from" and "suffering from".

Commenter number 30 proposed that the definition for *disabled household* be re-written to encompass all persons covered under applicable state and federal disability laws. The commenter requested that HCD be watchful for language such as "suffers from" and "suffering from" throughout the regulations and consistently utilize terms that promote independence and dignity for persons with disabilities.

Response: No substantive change is proposed in response to this comment. The language "suffers from" and "suffering from" is being changed to "has".

Discussion: The proposed regulation changes did not propose to change the definition of disabled household. Existing MHP regulations (7301(i)) define disabled household as follows:

"Disabled Household" means a household in which a member is suffering from an orthopedic disability impairing personal mobility or a physical disability affecting his or her ability to obtain employment, or in which a person requires special care or facilities in the home. "Disabled Household" also includes a household in which a member suffers from a developmental disability specified in subdivision 4512(a) of the Welfare and Institutions Code, or a mental disorder, which would render him or her eligible to participate in programs of rehabilitation or social services conducted by or on behalf of a public agency, or a single person with such a developmental disability or mental disorder.

Section 4512(a) of the Welfare and Institutions Code states:
a) "Developmental disability" means a disability which originates before an individual attains age 18, continues, or can be expected to continue, indefinitely, and constitutes a substantial disability for that individual. As defined by the Director of Developmental Services, in consultation with the Superintendent of Public Instruction, this term shall include mental

retardation, cerebral palsy, epilepsy, and autism. This term shall also include disabling conditions found to be closely related to mental retardation or to require treatment similar to that required for individuals with mental retardation, but shall not include other handicapping conditions that are solely physical in nature.

The commenter proposes adding the federal definition for developmental disability that reads as follows:
(8) The term "developmental disability" means a severe, chronic disability of an individual 5 years of age or older that - (A) is attributable to a mental or physical impairment or combination of mental and physical impairments; (B) is manifested before the individual attains age 22; (C) is likely to continue indefinitely; (D) results in substantial functional limitations in three or more of the following areas of major life activity - (i) self-care; (ii) receptive and expressive language; (iii) learning; (iv) mobility; (v) self-direction; (vi) capacity for independent living; and (vii) economic self-sufficiency; and (E) reflects the individual's need for a combination and sequence of special, interdisciplinary, or generic services, supports, or other assistance that is of lifelong or extended duration and is individually planned and coordinated, except that such term, when applied to infants and young children means individuals from birth to age 5, inclusive, who have substantial developmental delay or specific congenital or acquired conditions with a high probability of resulting in developmental disabilities if services are not provided.

The commenter proposes that the MHP definition refer to a physical or mental impairment that limits one or more major life activities and/or has a record of such impairment and/or is perceived by another as having such impairment. This formulation is apparently based on the non-discrimination statutes, particularly Government Code Section 12926. This code section has very detailed and complex definitions of "major life activity," "limits," etc. It is doubtful that the non-discrimination statute is the appropriate basis for determining program eligibility.

As an agency of the State of California, the Department believes use of the State Department of Developmental Services' definition for "developmental disability" (Section 4512(a) of the Welfare and Institutions Code) is more appropriate than a federal definition.

The Department concurs with the commenter's opinion that changing "suffers from" and "suffering from" to "has" is an appropriate textual enhancement of the definition for "disabled household".

<u>Section 7301(s)</u>

Comment: Do not delete *single parent household* from the definition for "Special Needs Populations".

Commenter number 8 noted that single parent households are a population in particular need of supportive services and should continue to be afforded recognition as a special needs population.

Response: The proposed change to delete *single parent household* is being rescinded.

Discussion: The Department agrees that there are circumstances that could warrant the need for supportive services for single parent households.

Section 7301(s)

Comment: Remove the term "frail elderly" as it is not defined and it is unclear how it differs from a person with a disability who is also elderly.

Commenter number 30 does not believe use of the term "frail elderly" is necessary to effect HCD's goal of limiting the definition of "Special Needs Populations" to only those seniors/elderly that "otherwise qualify" for that designation.

Response: No change is proposed in response to this comment.

Discussion: The definition for special needs populations became necessary because of specialized housing programs for such special needs groups as disabled households, homeless persons, chronically ill persons, people with AIDS, agricultural workers and others. Groups such as these may have housing needs that differ in design, facilities, tenure or services, from mainstream rental units for lower income households. The additional clarification pertaining to frail elderly that is included in Section 7301(s) is helpful as it is a term sometimes used to describe a population group that, by definition, is not considered a disabled household.

Section 7302(a) and 8301

Comments: The existing definitions for "dwelling unit", "efficiency unit" and "rental housing development" should be modified to provide for projects involving less than five shared houses (group homes); allow youth projects to be exempt from the 5-unit minimum for receiving points in the special needs populations category.

Commenter numbers 3, 5, 6, 7, 18, 20, 28, 29, 30, 31, 34 and 35 provided the following comments:

Shared housing is a model frequently used with disabled populations and, unless there are five or more, is not eligible pursuant to MHP regulations. HCD regulations should reflect state policy (commenter cited Welf. & Inst. Code Sections 5116, 5670 and 5670.5) in such a way as to facilitate the funding of smaller housing projects for people with disabilities. While prohibiting shared housing / group homes may not be a major concern in the general MHP pool, it inappropriately limits the effectiveness of the supportive housing program. Only small projects are feasible in small communities and group homes allow for better integration into the community. Many individuals with mental illness benefit most from living in shared housing. There are no other good sources of funding for shared housing models. These types of housing are frequently used to house people with psychiatric disabilities, developmental disabilities, and AIDS because it provides a more intimate setting and enables better service delivery. The model involves residents leasing individual locked bedrooms in a large house and sharing bathrooms, kitchens and living areas. Each resident holds a lease. Consider delegating MHP assistance to small, supportive housing programs (such as one house) to local government. Youth projects are unique because of the difficult-to-serve population, the high level of supportive services necessary, programmatic size restrictions for a successful and manageable program, and the vitriolic neighborhood opposition.

Response: No change is proposed in response to these comments.

Discussion: Proposition 46, which authorized the funding that is currently available for MHP, directed HCD to "consider, commencing in the second year of funding, the feasibility and appropriateness of modifying its regulations to increase the use of funds by small projects. In doing this, the department shall consider its operational needs and prior history of funding supportive housing facilities." This provision was included to address the interest of numerous parties in funding small projects, including many of the commenters. Its specific content reflected HCD's concern about the efficiency of funding many small projects, and especially small projects sponsored by groups with limited affordable housing experience. HCD wanted to make it clear from the outset that this subject would not be considered while the program was in its initial start-up phase.

Consistent with the direction provided by the statute, HCD will re-visit this subject in 2004. In the meantime, it continues to provide funding for special needs/supportive housing projects in larger projects, including those for persons with mental illness, and to work on numerous improvements in the program designed to facilitate supportive housing and special needs projects.

Section 7306(a)

Comment: MHP should provide construction period financing.

Commenter numbers 3, 11, 12, 14, 17, 24, 27, 28, 29, 31, 32, 34, 39 and 40 provided the following comments:

HCD should continue to pursue a construction period loan-to-lender program; the proposed arrangement with CalHFA should only be the start of a larger effort that would lead HCD to pursue loan-to-lender agreements directly with other public agency and private lenders. The CalHFA/HCD construction process should be clearly defined. HCD must be willing to accept construction period risk. Where a construction lender is using HCD's commitment of funds for collateral on a construction loan, HCD is already exposed to risk – and without any interest in the property. MHP construction financing would reduce financing costs to projects. The use of MHP funds for construction period financing should be allowed for all projects where a local jurisdiction is making a construction loan and providing construction monitoring. Special needs transactions that have no conventional lender should be allowed to use MHP funds during construction. Construction financing is not feasible for projects developed under the HUD Section 202 and 811 programs. There is an inefficient use of the State's tax-exempt private activity bond allocation, as projects will use tax-exempt bonds during construction only to have these bond proceeds refunded by MHP at permanent loan funding. Affordable housing has a lower appraised value than market rate units, and this lower value often results in a reduced construction loan. If HCD were to disburse funds during construction, this loan to value problem would no longer hamper many developers. HCD would benefit from actually putting their money in during construction and securing their debt with a position on title. HCD should apply retroactively this requested change.

Response: No change is proposed in response to these comments.

Discussion: Section 7306(a) authorizes use of MHP funds for construction period funding under an agreement with CalHFA to provide construction period financing to eligible projects receiving loans from both CalHFA and MHP. HCD is actively working with CalHFA to implement this program.

The Department agrees with many of the comments provided relative to the benefits of providing construction financing. However, at this time, HCD does not believe it to be feasible to pursue construction financing, outside of an arrangement with CalHFA, due to workload and personnel budgetary constraints. By providing permanent-only financing, HCD is able to ensure completion of successful projects on a greater scale with the limited staff currently available. Based on its experience working with CalHFA, and if administratively feasible, given the resources that are available to it in the future, HCD hopes to be able to eventually consider a more expanded construction lending program

The Department recognizes that it is difficult to arrange construction financing for HUD Section 202/811 projects when the construction lender cannot place a lien on the property. At the same time, it is instructive to note that ten applications have been awarded MHP funds in conjunction with the HUD 811 program.

Section 7307 (and 7317)

Comment: HCD should provide larger loans.

Commenter number 31 noted a problem of not being able to get to a loan amount that they need and suggested that HCD should provide for an increased loan amount if the operation of the MHP formula does not create a loan to fill the financing gap. The commenter suggested three alternatives to provide for a larger loan: 1) that loan amounts not be a function of the MHP income targeting objectives, 2) that HCD should increase the base per restricted unit loan amount to $40,000 for certain designated project types or 3) that the amount of the loan needed over that generated by the MHP formula could not exceed the lesser of (1) the loss of acquisition credits or (2) the remaining financing gap.

Response: No change is proposed in response to this comment.

Discussion: MHP loan calculations involve a base loan amount (currently $30,000 per restricted unit) plus a calculation based on unit size and level of rent restriction.

Regulations provide that HCD may periodically adjust the base amount. In making adjustments to the base loan amount, HCD considers loan demand, funding availability, trends in development costs, and trends in the terms and availability of supplemental funding sources.

The second part of the loan calculation is the amount per restricted unit required to reduce rents from 30% of 60% of AMI to the actual maximum restricted rent for the unit. This calculation assumes that the rent reduction will be achieved by substituting MHP funds for conventional funds.

The special NOFA rule (Section 7317) does not indicate that “designated project types” can be based on, or are entitled to, a waiver or modification of the program requirements. Nothing in the requirements for adjusting loan amounts indicates that they can be adjusted for special projects. The criteria for loan limit adjustments are broad-based and program-wide. They do not reflect an intent to permit adjustments for limited project types. The Department does not believe it is justified nor does it have the authority to modify the program by setting special loan amounts for "designated project types". The Department will continue to work with the commenter to address their concerns within the constraints of the program regulations and public policies.

Section 7311

Comment from Commenter number 12: The rules for over-income tenants should follow TCAC/CDLAC or HOME rules if the project has tax credits or HOME funds.

Response: No change is proposed in response to this comment.

Discussion: This regulation establishes a rule in the MHP program for the treatment of tenants that exceed the income limit for their household subsequent to initial occupancy. As MHP provides for multiple income and rent levels that vary from both TCAC and HOME, it is not possible to follow either the TCAC or the HOME rules on this subject.

Section 7311

Comment: The Department should establish a rule for the treatment of households whose incomes increase above 60% of area median income.

Commenter numbers 25 and 26 are concerned that the proposed regulation pertaining to over-income tenants does not address households with incomes at or above 60% of area median income. The commenters note that units lose their welfare property tax exemption at the time a household's income exceeds 80% (in some counties, less than 80%) of area median income and this can create a financial hardship on the project.

Response: Section 8307(a)(1)(A) is being revised to state that failure to maintain eligibility under MHP or other eligibility requirements as approved by the Department can constitute good cause for termination of tenancy. This revision is intended to make it clear that sponsors may terminate the tenancy of over-income tenants.

Discussion: The commenters have identified a situation whereby projects with welfare property tax exemptions may be financially disadvantaged when required to pay property taxes on units occupied by ineligible households with no mechanism to pass that additional cost on to the tenant by way of a higher rent. Furthermore, as MHP requires eligible households' income to not exceed the income limits specified by TCAC or other, lower income limits agreed to by a sponsor and the Department, it follows that sponsors should have the ability to make units available to new, eligible households when ineligible households' income exceeds 80% of area median income or cause the loss of the unit's welfare property tax exemption.

Section 7311(a)(3)

Comment from Commenter number 30: HCD should make the language explicit that units cannot be considered similar or comparable unless they are as physically accessible, or more accessible, to people with disabilities than the existing unit to which they are being compared.

Response: No change is proposed in response to this comment.

Discussion: Section 7311(a)(3) governs income levels as they relate to maintaining the required unit mix and, in no case, would it effect relocation of an existing tenant.

Section 7312(c)

Comment: With one exception, commenters would prefer that HCD not limit the amount of annual rent increases. The exception supported the proposed amendment to the regulations.

Commenter number 12 supported the proposal noting that sponsors should increase rents regularly rather than with less frequent, yet more substantial increases.

Approximately nine Commenters expressed various concerns and provided various suggestions addressing those concerns. Their major concerns were the administrative effort required to keep track of yet another limit on rent increases and the potential impact on feasibility resulting from reduced rental income. This group of commenters would either prefer no limit on annual rent increases or a higher limit.

Response: The proposed regulation amendment is being rescinded. Further, the existing limit on the amount of annual rent increases is proposed for deletion from the regulations.

Discussion: The Department accepts the argument that the administrative burden associated with the additional cap may exceed the benefit to project tenants.

Section 7312(f)

Comment from Commenter number 14: HCD should change the reference to State Median Income, as the affordability will now be expressed in term of Area Median Income.

Response: This subsection is being revised to add, “expressed as a percentage of Area Median Income”.

Discussion: The Department concurs with the comment.

Section 7312(f)(2)

Comments from Commenter number 26: The transition reserve created for the purpose of forestalling rent increases in the event of the termination of renewable project-based rental assistance destroys project underwriting and leveraging of other funds.

Response: This comment is outside the scope of the proposed amendments to the MHP Regulations. No change is proposed in response to this comment.

Discussion: The transition reserve account must be large enough to subsidize rents for two years in the event a rental assistance contract is terminated. If rental assistance is terminated, rents must be set at the lowest levels consistent with the fiscal integrity of the project. For units that scored points for the sponsor in the application process for serving households at the lower income levels, this rent level may not exceed 30 percent of 50 percent of area median income.

This subdivision is intended to minimize hardship on the tenants, if the loss of rental assistance is not accompanied by tenant-based assistance, and to preserve project feasibility, if the loss of rental assistance leads to an exodus of tenants or other event that reduces rental income.

Section 7317

Comment: Amend the regulations to allow use of MHP funds with 9% tax credits.

Commenter number 33 pointed out that, as a predominately rural developer, they have been unable to serve lower income rural communities through the use of MHP funds coupled with 4% tax credits. The commenter noted that 9% tax credit investors provide significant leverage of other funds.

Response: This comment is outside the scope of the proposed amendments to the MHP Regulations. No change is proposed in response to this comment.

Discussion: In light of the uncertainty of obtaining the highly oversubscribed 9% tax credits and the relative availability of 4% tax credits, the Department has not permitted the use of 9% tax credits in conjunction with MHP. MHP requires a portion of all MHP funds be awarded to rural projects by way of a 10% set-aside. Rural projects also receive an advantage over non-rural projects in the scoring category for leverage of other funds. The HOME and JSJFWHG programs provide funding targeted to rural areas.

Section 7320

Comment: HCD should provide a scoring advantage for acquisition-rehabilitation projects.

Commenter numbers 4, 21, 22 and 23 provided the following comments:
Sites for new construction projects are sometimes difficult to locate. Acquisition-rehabilitation projects that create units with three or more bedrooms may cause tenant displacement. Many older, USDA-financed projects suffer from deferred maintenance and should be preserved.

Response: No change is proposed in response to this comment.

Discussion: Given there is greater need for affordable units with three or more bedrooms, the Department has purposefully structured MHP to reward those projects with a scoring advantage. Providing a scoring advantage to acquisition-rehabilitation projects with less bedrooms runs counter to the desired outcome. Notwithstanding the limited scoring advantage for true “at-risk” projects, this outcome is focused on the populations to be served in lieu of buildings with deferred maintenance. Even so, it should be noted that many acquisition-rehabilitation projects have successfully competed and received an MHP award.

Section 7320

Comment: HCD should provide a scoring advantage for senior projects.

Commenter numbers 2, 3, 9, 12, 24, 28, 29, 31 and 32 provided the following comments:

HCD should allow senior projects to be competitive. Senior housing funding should be capped based on a percentage of the very low-income population. Provide additional points to senior projects if they are close to medical facilities or senior centers. Provide a scoring advantage for senior congregate care and assisted living.

Response: No change is proposed in response to this comment.

Discussion: By statute, MHP is required to emphasize projects that contain a significant number of units for families or special needs populations. Accordingly, the competitive system it employs to select projects does not single out senior projects for special preferential treatment. The rationale for this approach is that seniors are reasonably well served by other funding programs, and that the greatest unmet need is for housing other populations.

In spite of this emphasis on families and special needs populations, MHP is already producing units for seniors in roughly the same proportion as the ratio of seniors relative to the total population. Many of these units are in age-restricted developments, which can be competitive if they contain units for disabled seniors or qualify as federally subsidized "at-risk" projects. Others units occupied by seniors are in family or special needs developments that are not specifically age restricted. Give these circumstances, the Department does not believe it is necessary to provide any particular incentive for senior projects.

MHP does not automatically exclude congregate care or assisted living projects. If the residents of a certain percentage of units in an assisted living or congregate care project were disabled, the project would qualify for scoring points in the special needs category.

Section 7320

Comments from Commenter number 24: HCD should give three or bedroom units a scoring weight equal to special needs units. HCD should increase points for the scoring category to fifty points.

Response: No change is proposed in response to these comments.

Discussion: The Department believes the scoring system as currently configured is resulting in the desired policy outcomes and it is not necessary to change it at this time.

Section 7320

Comment: HCD should count deferred fees as leverage.

Comment from Commenter number 32: A deferred developer fee is an investment in the project by the developer that may not be recouped for years. The prohibition on allowing deferred fees to count as leverage should be removed or HCD should recognize those deferred fees that have a longer-term recovery.

Response: No change is proposed in response to this comment.

Discussion: The Department does not agree that deferred developer fees should be characterized as a project investment that should be rewarded with a scoring advantage in the same manner as other leveraged funds. Deferred fees are not a source of cash to cover development costs.

<u>Section 7320</u>

Comment: HCD should reduce the scoring advantage given for targeting of units to extremely low income tenants.

Commenter numbers 11, 13, 24 and 26 provided the following comments:
Bond projects with deep targeting need significant local government assistance. Since localities are apt to not have this assistance available in the future and, to promote mixed income projects, scoring for bond projects should be based on the percentage of units at 50% and 60% of area median income. Deep targeting may create feasibility problems. Deep targeting requires too much subsidy. The working poor may not be able to qualify for deeply targeted units in high cost areas.

Response: No change is proposed in response to this comment.

Discussion: Based on the first four MHP funding rounds and the ongoing program demand, HCD has not observed that the deep targeting has created the kinds of problems envisioned by the commenters. The MHP program has resulted in a wide range of income-targeted households ranging from those with extremely low incomes to those at 60% of area median income. It should also be noted that some MHP projects have been structured with market-rate, non-subsidized units.

<u>Section 7320</u>

Comment from Commenter number 24: HCD should not make fee title or plan status readiness tests.

Response: No change is proposed in response to this comment.

Discussion: HCD accepts the premise that it should not be essential to incur out-of-pocket costs at application stage. MHP has been structured with this in mind and, thus, does not require fee title or working drawings at the application stage. MHP allocates two and one half points for having either fee title site ownership (or leasehold) or working drawings that are 50% complete. The Department believes, given the overwhelming, pressing demand for affordable housing together with the beneficial, immediate impacts on local, regional and the state's economies, that projects farther along in the development process should receive this slight scoring advantage.

<u>Section 7320</u>

Comment from Commenter number 30: HCD should award points for units fully accessible to people with mobility and sensory impairments, or make this a threshold requirement.

Response: No change is proposed in response to this comment.

Discussion: At this time, no statewide standards have been established to define when a unit is fully accessible to people with mobility and sensory impairments. In the absence of such a standard, HCD would not be able to make a determination if any given unit is or is not truly accessible.

Section 7320

Comments from Commenter numbers 11 and 13: Historically, Los Angeles County and southern California have not received their fair share of HCD funds. HCD should administer the program in such a way to avoid this outcome.

Response: No change is proposed in response to this comment.

Discussion: While the comment may be valid for earlier programs, the first four funding rounds of MHP have evidenced a "fair share" of awards to southern California. Thus, HCD does not believe it is necessary to alter the MHP program's geographic distribution that awards no less than 45% of funds to projects in southern California, no less than 30% in northern California and no less than 10% in rural areas.

Section 7320

Comment from Commenter number 24: HCD provides too much advantage for "at-risk" developments.

Response: No change is proposed in response to this comment.

Discussion: "At-risk" developments, as defined in TCAC regulations, are a priority for MHP funds. These developments are existing, federally subsidized projects that are at risk of losing their subsidies, or of the owners not renewing their subsidies, and converting to market rents. Since the preservation of the rent restrictions can often be accomplished at lesser cost than building new units, the funding of this class of project is often an efficient use of money. Funding "at-risk" developments also avoids inconvenient and costly displacement and relocation of the tenants.

Section 7320(b)(3)

Comment: HCD should revise the experience scoring category.

Commenter numbers 3, 11, 12, 14, 15, 18, 24, 28, 29, 31, 34 and 36 provided the following comments:
If at least one project has been developed within the most recent five years, the score should be based on the previous ten years of experience. Development consultant's experience should fully substitute for sponsor's experience. Include the development of single-family subdivisions

as an acceptable form of experience. The experience category should provide an alternative scoring method that considers the number of units that have been developed in lieu of the number of projects. The experience score should include the experience of affiliates when the affiliate is a non-profit affiliate of a public agency that contracts with the public agency for staffing.

Response: No change is proposed in response to this comment.

Discussion: Health and Safety Code Section 50675.7(c)(3) establishes that projects eligible for funding be evaluated with consideration to the extent and success of the development experience of the entity developing and owning the proposed project. Market conditions, funding sources, and construction requirements are ever changing. Recent activity of the project sponsor is a valuable indicator of the capacity of the sponsor to develop a project under current market conditions. HCD observes that fully substituting a consultant's experience for the sponsor's experience would effectively negate the Department's desire to provide a competitive advantage to experienced sponsors. MHP already includes the experience of affiliates when calculating experience points.

Section 7320(b)(7)

Comment from Commenter number 16: The new scoring category, Adaptive Reuse / Infill / Proximity to Amenities, would disadvantage rural and other, similar projects against projects in more urbanized areas.

Response: No change is proposed in response to this comment.

Discussion: The Department has limited discretion relative to this new scoring category, as it was required by SB 1227 (Proposition 46).

Section 7320(c)

Comment from Commenter number 19: It is unclear if the tiebreaker will be expressed as state median income or area median income.

Response: No change is proposed in response to this comment.

Discussion: Tie scores will be ranked based on the lowest weighted average affordability of the restricted units calculated using the projects' targeted area median income limits.

Section 8301(j)

Comment: Some supportive services costs, beyond the salary of a services coordinator, should be included in the definition of "operating expense".

Commenter numbers 2, 3, 11, 14, 26, 28, 29, 32 and 33 argue for classifying certain supportive service costs as operating expenses, and thereby making them eligible for payment out of project operating income on a priority basis.

Commenter numbers 3, 11, 28, 29, and 32 suggest allowing 5% of total operating expenses to be used for the type of services that are encouraged by the California Tax Credit Allocation Committee and other funding sources, such as after-school educational programs. **Commenter 32** suggests $10,000 as a cap on such services, if a cap is deemed necessary, and provided that it is indexed for inflation.

Commenter number 12 expresses concern about the cost of service coordination, and suggests that it be capped.

Response: No change is proposed in response to these comments.

Discussion: HCD recognizes the value of various social and educational services to residents of affordable housing, and especially to residents who are extremely low income. It encourages sponsors to arrange for the provision of such services. At the same time, HCD is also cognizant of the fact that funding services through the project operating budget reduces the ability of the project to support debt service, thereby increasing the required subsidy and decreasing the number of units produced. And finally, HCD is concerned about the difficulty of monitoring whether funds budgeted for services actually are used for this purpose.

To balance these considerations, the initial regulation proposal allowed service coordination to be considered an operating expense, but not direct services. HCD still believes this to be the best approach. A major function of a service coordinator is to link residents with existing services, so that additional project operating revenues do not have to be used for this purpose. In addition, these regulations allow sponsors to receive substantial cash flow from project operation, some of which could readily be applied toward services.

At some point in the future, HCD may consider establishing a standard for the amount of funds that may be budgeted for service coordination. At this point it lacks sufficient experience in this area to set a standard.

Section 8303

Comment from commenter 16: Accept as evidence of site control a letter from a redevelopment agency indicating that the agency is in the process of giving the project sponsor site control.

Response: No change is proposed in response to this comment.

Discussion: For sites being conveyed to the sponsor by public agencies, the initially proposed regulations already accept as evidence of site control an agreement granting the project sponsor exclusive negotiating rights for acquisition of the site, provided that the major terms of the transaction have been agreed upon. By accepting this agreement, HCD achieves its goal of having reasonable certainty that the project sponsor will not lose their site, without forcing it to wait for the often lengthy process of finalizing a disposition and development agreement. Without a formal agreement, HCD has no real assurance that the site will actually be available. A letter from a redevelopment agency conveying current intent does not provide the necessary certitude.

Section 8304

Comment: To allow for incorporation of affordable units into mixed-income projects, allow these units to be smaller and have fewer amenities than the other units, at least if the reductions in this area are offset by other factors, such as an enhanced service program.

Commenter 14 made this comment. **Commenter 10** commented in support of the provision proposed by HCD.

Response: No change is proposed in response to this comment.

Discussion: HCD acknowledges that it may be possible to produce more affordable units if these units do not have to meet the standards of those targeted to higher income households. However, it is concerned about the stigmatizing effect of relegating low-income people to inferior units. It also believes that units are apt to be better maintained if, upon vacancy, they may be re-rented either on the open market or to a low-income household for a below-market rent.

Section 8305(a)(3)

Comment: In unincorporated areas, allow residency preferences to be applied to regions within a county, rather than to the entire county.

Commenters number 2 and 25 made this comment.

Response: This subsection is being revised to allow residency preferences to be applied to recognized communities within unincorporated areas.

Discussion: The intent of this provision was to allow, under certain circumstances, local preferences where they applied to areas larger than individual neighborhoods. In unincorporated areas, this intent is consistent with allowing preferences to apply to generally recognized communities, which are akin to incorporated cities.

Section 8305(a)(3)

Comment: **A**llow preferences for neighborhood residents, rather than to residents of a municipal jurisdiction, to alleviate overcrowding.

Commenter number 11 made this comment.

Response: No change is proposed in response to this comment.

Discussion: A major objective of this provision was to make it difficult for preferences to be used in a manner that limits access by certain racial or ethnic groups. Since neighborhoods often have limited numbers of one or more ethnic groups, allowing preferences by neighborhood would run contrary to this objective. Also, HCD is not aware of any evidence that limiting affordable housing to those who live in a particular neighborhood actually reduces overcrowding.

Section 8305(a)(3)

Comment: To prevent gaming of preferences for those who work in a community, clarify that the work must be substantially full time.

Commenter number 13 made this comment.

Response: No change is proposed in response to this comment.

Discussion: HCD agrees with the point of the commenter that for this provision to have any real meaning the qualifying employment must be genuine. However, HCD is unsure about how to set a standard for defining precisely what this means. At least for now, it prefers to give sponsors some flexibility in this area, and to allow them to establish specific tenant eligibility requirements in their management plans, which HCD will review.

Section 8305(b)

Comment: Make it clearer that the Sponsor may approve exceptions to the minimum occupancy standard set forth in this section without HCD approval.

Commenter number 33 made this comment.

Response: Section 8305(b) is being revised to explicitly allow sponsors to obtain advance approval of categorical exceptions to the specific numerical standard set forth in the regulation.

Discussion: HCD expects to defer to Sponsor judgment on this issue in most cases. However, it needs authority to object to tenant selection practices that lead to significant under-utilization of large units. The revision specifically allows sponsors to receive clear advance approval of categorical exceptions to the standard rule. This is intended to reduce the administrative burden that would result if decisions were made on a household-by-household basis.

Section 8305(b)

Comment: Allow three people to occupy three-bedroom units.

Commenter number 2 made this comment.

Response: No change is proposed in response to this comment.

Discussion: There are circumstances under which the standard proposed by the commenter would be highly appropriate, such as when the household consisted of a single parent, a teen-age son and a teen-age daughter. However, there are also many circumstances under which the standard would lead to under-utilization of the unit, such as the case of a household consisting of two parents and one child. Given the high need for three bedroom units by families that clearly need all three bedrooms, HCD does not want to adopt a rule that sanctions underutilization. Instead, it would like sponsors to use the discretion accorded them by this subsection to make exceptions to the basic rule (four people in a three-bedroom unit) based on the specific configuration of the household in question.

Section 8306(b)

Comment: Make it clearer that the Sponsor may approve exceptions to the minimum occupancy standard set forth in this section without HCD approval.

Commenter number 33 made this comment.

Response: Section 8306(b) is being revised to clarify that sponsors have discretion in relocating households that have decreased in size and no longer meet the minimum occupancy standards set forth in Section 8305(b).

Discussion: The initially proposed language was confusing, because it seemed to grant the sponsor complete discretion but then suggested that the sponsor's determination was subject to HCD review. Upon reflection, HCD has come to the conclusion that the administrative effort required for it to monitor household composition, following the household's initial occupancy of their unit, probably exceeds the benefit of making sure that households continue to occupy appropriately sized units. For this reason, this section has been revised to delete the provisions that suggest that the sponsor's determination is subject to HCD review.

Section 8307(a)

Comment: The good cause for eviction requirement makes it difficult to evict suspected gang members, who often are able to silence potential witnesses through intimidation.

Commenters number 2 and 11 made this comment.

Response: No change is proposed in response to this comment.

Discussion: HCD recognizes that requiring good cause for eviction makes it more difficult and expensive for property mangers to evict tenants who should be evicted. However, the burden this requirement places on sponsors and their agents needs to be balanced against the protection it provides low-income tenants. Based on the experience of its various rental housing programs over the past 20 years, most of which have had the just cause requirement, it is HCD's judgment that the benefit of this important tenant protection outweighs the additional cost and administrative burden.

Section 8307(a)

Comment: The good cause for eviction requirement should not supersede local laws that are more restrictive.

Commenter number 12 made this comment.

Response: Subsection (d) is being added to clarify that this section does not supersede more restrictive local laws.

Discussion: This revision is being done for clarity only. HCD does not believe that its regulations pre-empt or supersede more restrictive local ordinances in this area.

Section 8307(a)

Comment: Allow eviction of tenants whose incomes rise to the point where they no longer need affordable housing.

Commenter number 26 made this comment.

Response: This subsection is being revised to specify that good cause for eviction includes failure to maintain eligibility under requirements other than those of the HCD program that is providing assistance.

Discussion: This change allows the sponsor, subject to HCD approval, to set maximum income limits, and to terminate the tenancy of those whose incomes exceed these limits, so that their unit can be made available to tenants with a greater need for assistance.
HCD agrees that affordable housing should be preserved for those w**ho** need it the most.

Section 8308(b)

Comment: The amount of the required operating reserve funding is excessive.

Commenter number 12 generally supported HCD's initial proposal, and **commenter 37** thought the amount was about right but suggested not requiring that it all be funded up front. The rest of the commenters argued for a lower requirement, or for no requirement. **Commenter numbers 33 and 26** suggest reducing the requirement from 4 months of operating expenses, reserve deposits and debt service to 3 months. **Commenter number 13** suggested 3 months of operating expenses only. **Commenter number 17** suggested deferring to the requirement of other funding sources. **Commenter number 24** suggested using the operating reserve requirements of major equity investors or secondary market institutions. **Commenter 26** suggested adopting CalHFA's standard, and allowing it to be satisfied with a letter of credit instead of cash.

Response: This subsection has been revised to reduce, for tax credit projects, the minimum operating reserve requirement to 3 months of operating expenses, reserve deposits and debt service.

Discussion: HCD's intent with the initial proposal was to establish a requirement that was consistent with industry standards. Accordingly, it based the proposed regulation on the standard included in the National Council of State Housing Agency's housing tax credit best practices guide ("Recommended Practices in Allocation and Underwriting"). Based on a survey of equity investors active in California, however, it appears that the typical requirement in California is less than that recommended by the national guide. For tax credit projects, the revision conforms the HCD requirement to investor norms.

Projects without low-income housing tax credits lack the financial backing of a deep-pocket tax credit investor. They often are developed by less experienced groups, and frequently have thinner operating margins as well. For this reason, HCD is retaining the originally proposed 4 month requirement for projects without tax credits.

Section 8309(a)

Comment: HCD control over replacement reserve withdrawals should be limited to instances where the withdrawals deplete the reserve below a specific minimum amount, or should be eliminated.

Commenter numbers 26 made this comment. **Commenter numbers 17 and 25** stated that HCD should not approve replacement reserve withdrawal requests.

Response: No change is proposed in response to this comment.

Discussion: HCD recognizes that its control over reserves creates an administrative burden for project sponsors, many of whom would typically spend reserves appropriately without any oversight. However, there is significant potential for misuse of reserve funds, and some system of oversight is necessary. HCD is unclear why a system that gives sponsors unfettered control over some portion of the replacement reserve account would prevent misuse, especially since the account balances for many projects are inadequate to fully meet replacement needs. HCD would welcome a more specific proposal in this area, as long as it includes clear safeguards to prevent misuse.

Section 8309(b)(1)

Comment: The amount of the required replacement reserve deposits for new construction projects is too high.

Commenter number 12, a local funding agency, strongly supported HCD's proposal, noting its experience with projects that lacked adequate reserves. **Commenter** numbers 16 and 37, both developers, also support the proposal. Numerous other commenters, all developers **(28, 14, 3, 32, 25, 26)** suggested that the proposed standard was excessive**. Commenter numbers 25, 28 and 29** proposed $400 per unit as the appropriate standard. **Commenter 32** proposed deferring to TCAC's requirement. **Commenter 24** indicated that FNMA / Freddie Mac standards should suffice. **Commenter 10** suggested that HCD defer to local funding agencies. **Commenter 33** recommended basing the calculation on "only the hard actual structure cost."

Response: Subsection 3309(b)(1) is being revised to clarify the exact budget line items that are included in the basis for calculating the replacement reserve deposit amount.

Discussion: The change is intended as a clarification only, and conforms to the existing practice of MHP and HUD, which was the originator of this standard.

The chief rationale cited by commenters for reducing the replacement reserve deposit requirement is that it exceeds industry norms. This is accurate. However, there is significant evidence indicating that industry norms are inadequate for many of the projects funded under

HCD's programs, at least given the 55-year time horizon of these programs. Most of this evidence is anecdotal. It includes the experience of a number of projects in HCD's portfolio, and reports from other funding agencies, such as commenter number 12, a local government housing agency, and USDA's Rural Housing Service (RHS). RHS has a large portfolio of older projects. Even though RHS has historically required a higher reserve deposit than that specified in this regulation (1% of total development costs, with adjustments vs. 0.6% of structure construction costs), it has experienced severe and widespread problems due to the inadequacy of the deposit amounts. On the national level, RHS is currently is proposing regulations that would increase required deposit levels for many projects. Its California office has completed a study that indicates that typical multifamily developments in this state need approximately $900 per unit in replacement reserve deposits to cover their capital needs over a 20 year period.

One of the few other systematic studies on replacement reserve funding that HCD has been able to locate was prepared by On-Site Insight in 2001. Based on capital needs assessments performed on 183 mostly older HUD and state housing finance agency assisted projects, it indicated a need for approximately $16,000 per unit to cover replacement needs for a 20 year period. This equates to approximately $800 per unit per year, which is nearly twice the requirement of the regulation for a typical project located outside of the most costly areas of the state.

Having said this, HCD acknowledges that the formula established in the regulation may well overstate actual replacement reserve needs for some projects. For this reason, this subsection specifically allows sponsors to demonstrate the adequacy of a lower deposit amount, through a third party reserve study. It also grants HCD the authority to use other reliable indicators of the need for replacement reserve funds as the basis for exceptions to the formula. Eventually, HCD hopes that it will be able to use its collection of completed reserve studies as the basis for determinations on new projects, without additional studies. And finally, Section 8310 (i) allows use of an amount less than the 0.6% standard during initial project underwriting, pending receipt of a study.

Section 8309(b)(2)

Comment: Physical needs assessments (PNAs) are not required by any other state agency, overstate reserve needs because they include costs for items that will be addressed by the planned rehabilitation, and are costly due to the limited supply of firms able to do them.

Commenter number 32 made this comment. **Commenter numbers 28 and 3** urged that PNAs be used flexibly, as the basis for discussions.

Response: No change is proposed in response to these comments.

Discussion: PNAs are required by other funding sources, including CalHFA (a state agency) and FNMA (a national secondary market institution). If performed according to HCD's instructions, they do not include costs for items that will be addressed by the planned rehabilitation. HCD acknowledges that there is a shortage of firms qualified to perform these assessments, which may inflate their cost. However, they are key tools for evaluating both the adequacy of the planned rehabilitation and the level of reserve funding needed over time.

HCD recognizes that PNAs may occasionally be imperfect, and need to be used judiciously.

Section 8310(b)

Comment: Allow exceptions to the 50% commercial vacancy rate underwriting assumption.

Commenters number 2 and 14 made this comment.

Response: No change is proposed in response to this comment.

Discussion: HCD adopted this standard as a result of difficulties with commercial space experienced by a number of projects that it has funded over the years. It has come to the conclusion that it lacks sufficient expertise in underwriting commercial space (and that most affordable housing developers also lack this expertise) to use a less conservative standard.

Section 8310(e)

Comment: Modify the 1.20 debt service coverage ratio limit.

Commenter number 2 argued for the elimination of this limit, as it has a negative impact on feasibility. **Commenter number 33** suggested an exception as needed to meet the requirement of subsection (h). **Commenters number 11 and 31** suggested an exception to meet the requirements of other lenders.

Response: This subsection is being revised to allow two additional exceptions: where exceeding the 1.20 limit is necessary to meet CalHFA's standard underwriting requirements, and where necessary to meet the requirements of subsection (h).

Discussion: Based on extensive experience with actual projects, HCD is confident that the 1.20 requirement, with exceptions, will not unduly impair feasibility. It understands the argument about the need to meet other lender's requirements, but is uncomfortable with an open-ended exemption for this purpose, which may allow other lenders to avoid risk they would ordinarily take by imposing an especially stringent requirement on one or more MHP projects. It is proposing a special exception of this nature for its sister agency, CalHFA, which uses especially stringent but well-defined underwriting assumptions. Although HCD's analysis suggests that an exemption to meet the requirements of subdivision (h) is probably unnecessary, this subsection is being revised to allow for this exception, as a precautionary measure.

Section 8310(f)

Comment: Allow balloon payments on senior debt.

Commenter number 17 made this comment.

Response: No change is proposed in response to this comment.

Discussion: If long-term, fully amortized debt was not readily available on attractive terms, HCD understands why it would be reasonable to consider taking the extra risk associated with balloon payments. Given the plentiful supply of such debt, however, HCD does not believe it necessary to take this risk.

Section 8311(e)

Comment: Relax the requirement that property purchase price may not exceed appraised value.

Commenter number 33 argued for relaxing the limit, based on the inexact nature of the appraisal art and the need to pay a premium for delaying purchases while financing is being arranged. **Commenter number 17** indicated that sponsors sometimes pay a premium to acquire specific properties that are poorly managed and problems for the community. **Commenter 10** expressed appreciation for acknowledging that purchases driven by public agencies (and that target specific projects) sometimes require above-market purchase prices.

Response: This subsection is being revised to clarify that the purchase price must be supported by (rather than equal to) appraised value.

Discussion: The revision is intended to give HCD some flexibility to approve prices that are modestly above appraised value. HCD accepts the notion that appraisals aren't always perfect, and that affordable housing developers sometimes need to offer higher prices because they are unable to close the transaction quickly. Where a specific problem project is being targeted by a locality, HCD believes that local government should cover any significant cost increment above fair market value.

Section 8311(d)

Comment: Relax the requirement on site development costs, to allow sponsors to tackle sites with high costs.

Commenter number 16 made this comment.

Response: No change is proposed in response to this comment.

Discussion: Sites requiring costly site improvements are worth less than other sites. This regulation is designed to prevent overpayment for such sites, and to encourage sponsors to aggressively seek out sites where the cost of unusual site improvements is not mitigated by a discounted purchase price.

Section 8312, 8313 and 8314

Comment: Modify the proposed limits on developer fee, including the limits on deferred fee payable from cash flow.

Commenter numbers 2, 15, 18, 26, 29,12, 14, 3, 9 and 11 all commented that the proposed fee schedule was too generous at the upper end (for large projects with high cash flows) and too stingy at the lower end (for small projects and/or those with limited cash flow). Most of these commenters also argued for higher fees for Section 811 and 202 projects. **Commenter 25** indicated that $1.2 million should be an absolute cap. **Commenter 32** stated that fee limits only serve to limit the ability of nonprofits to develop housing. **Commenters 16, 39 and 33** argued in favor of the TCAC limits on developer fee. **Commenters 39 and 40** suggested that the new limits be applied retroactively. **Commenter 2** supported the proposed increase in the amount of allowable cash flow.

Several commenters, including numbers **2, 26, and 12**, proposed that the existing fee structure be modified by increasing the per unit amount for the first thirty units from $15,000 to $20,000. **Commenter 32** proposed that this adjustment be made for projects with 50 or fewer units; this commenter also proposed a different schedule (perhaps applicable to larger projects?), which would keep the per-unit amount to $15,000 for the first 30 units but increase it to $12,500 for the next thirty units. **Commenter 10**, a local government agency, proposed that HCD defer to local government agencies on this matter.

Response: For clarity, Sections 8313 is being combined with Section 8312, and the new combined section is being reworded. Substantive revisions are: (1) an increase in the per-unit amount from $15,000 to 20,000 for the first thirty units (2) a change in allow deferred developer fee for tax credit projects, which now allows total developer fee to reach the lesser of $1,200,000 or the amount includable in eligible tax credit basis and (3) the elimination of a separate fee schedule for HUD 811 and 202 projects.

Discussion: HCD recognizes that the fee schedule in the initially proposed regulations provides inadequate compensation for small projects. Given recent changes in TCAC rules, which more than doubled the allowable fee for large projects, the upper limit in the proposed regulations is also recognized as excessive.

The increased allowance for fees for 811 and 202 projects is intended, in part, to incentivize supportive housing, which has been under-subscribed in MHP.

<u>Section 8314</u>

Comment: Modify the system for regulating project cash flow.

In addition to the comments on the proposed rules on cash flow as funding for developer fee, a variety of miscellaneous comments were received on this subject. **Commenter number 16** supported the HCD proposal. **Commenter number 25** supported the general thrust of the proposed changes, but suggested that a modification in the developer fee limits was needed along with them. **Commenter number 12** supported payment of asset management fees on a priority basis, but only if the sponsor has asset management staff and comprehensive capital improvement plan, is fully funding reserves, and is otherwise is in full compliance with program requirements. **Commenter 33** suggested allowing partnership / asset management fees in the $10,000 to $15,000 range, even if there was no local funding agency, and with the amount to be increased based on inflation. **Commenter 24** suggested allowing priority payments on mezzanine debt, and distributions to be taken during the year if the sponsor posted a bond or guarantee. **Commenter 26** indicated that not allowing distributions to cumulate from year to year will force owners to implement maximum rent increases. This same commenter opined that the cap on rent increases, the recapture of Section 8 income, and large reserve requirements would result in minimal cash flow. They also questioned the appropriateness of HCD control of cash flow in the event that the HCD loan was repaid. **Commenter 10** suggested that HCD defer to local agency regulation of project cash flow.

Response: Subsection (a)(1)(B) is being revised to allow payment of an asset management fee, in a specified amount, where there is no locality funding. Subsection (a)(2)(C) is being revised to clarify that only the incremental income from project-based Section 8 income is subject to recapture in full. Subsection (c) is being revised to clarify that deferred developer fee and asset/partnership management and similar fees, along with distributions, are not payable when a notice of default has been declared, or when there is another serious problem with the development.

Discussion: The revision to subsection (a)(1)(B) is designed to provide a reliable source of funds to cover the sponsor's cost of overseeing completed projects, and to set a standard for the amount of the payment for this purpose, where a local funding source has not already set such a standard. Based on experience in other programs, HCD has found that project oversight is improved if compensation is available for this purpose. The $12,000 payment standard set forth here has been used for several years by several HCD programs, including HOME. (The reason the regulation uses the term "asset management" is to draw a clear distinction between the function of managing the property and other functions, such as administering the partnership.)

The intent behind subsection (a)(2)(C) was to encourage sponsors to seek out primary lenders who would underwrite project-based rental assistance, and to prevent sponsors from realizing a windfall where this assistance was not being underwritten. It was not designed to recapture sporadic income from tenants who have tenant-based subsidies. As evidenced by the comment, this intent was not clearly spelled out in the initial draft of the regulation, so it is being clarified.

The revision to subsection (c) was prompted by the comment that payment of asset management fees should be conditioned on performance. The first part of this subsection already incorporates this idea, in part, by providing that fees may be paid only after submission of the required annual report and operating budget, etc. A logical extension of this concept is to preclude payment of such fees when the sponsor is in default, has not funded their reserves, or otherwise meets one of the specifically enumerated conditions listed at the end of the subsection.

With respect to the comments that did not result in any change:

1. HCD does not believe that the regulations as drafted preclude using cash flow for payments on third-party mezzanine debt.

2. Allowing mid-year distributions based on the posting of a bond or some other security would create an administrative burden that HCD is not able to take on at this point.

3. The rule prohibiting accumulation of distributions has been a feature of several HCD programs for many years, and some sponsors using these programs have elected not to raise rents at the maximum allowable levels. Based on this experience, it does not appear that this provision forces such increases.

4. The comments on the rent increase and developer fee caps and reserve requirements are addressed in other sections of this document.

5. HCD does not expect that loans made under these programs will be repaid in full during their term. If this occurs, it will be open to alternatives for use of surplus project cash.

6. Complete deferral to local agency policies, which could result in a different deal for virtually every project, would create unnecessary administrative complexity, and increase processing and monitoring cost.

<u>Section 8315</u>

Comment: HCD should subordinate to local agency funding sources if their loan amount is greater.

Commenter numbers 11, 12 and 32 made this comment.

Response: No change is proposed in response to this comment.

Discussion: Historically, HCD has required that localities subordinate to it, irrespective of relative loan amounts. The proposed policy, currently in effect only for MHP, is significantly more favorable to localities. By putting the localities' money most at risk, unless they have an extremely large investment, it is intended to encourage them to closely monitor their portfolio, and to participate in curing any problems that may arise.

<u>Section 8315</u>

Comment: Allow more flexibility in the section on subordination policy and conform to FNMA and Freddie Mac requirements.

Commenter numbers 13 and 24 made these related comments.

Response: No change is proposed in response to this comment.

Discussion: The primary goal of this section was to create a clear, fixed standard that would head off protracted and expensive negotiations for individual projects. Building in flexibility would run counter to this goal. Based on experience to date, HCD believes that these requirements will end up being acceptable to the secondary market.

<u>Section 8316</u>

Comment: Exempt some projects or build in more flexibility to the requirement for projects using ground leases.

Commenter numbers 11 and 27 asked for an exemption for projects on state-owned land. **Commenter number 11** also requested an exemption for projects that were already in the works. **Commenter number 13** suggested more flexibility. **Commenter number 19** noted that the requirements of this section may cause problems for projects located on land owned by the

Irvine Company, which generally does not enter into ground leases that expire upon the termination of 55-year affordability restrictions.

Response: Subsection (a)(2)(A) is being revised to allow HCD to accept a lease term less than 90 years, but at least 65 years, where the lessor is a public agency. Subdivision (c) is being added to allow the department to modify or waive other requirements for public agencies where there is both a legal prohibition on the requirement and HCD determines that modifying it will not jeopardize HCD's loan security. As technical changes, duplicative language [subsection (a)(2)(F) in the initially proposed regulations] is being deleted, and the wording of (a)(2)(K) [revised to be (J)] is being modified.

Discussion: HCD has less concern about loan security for projects on land owned by public agencies, and for this reason is willing to accept a lesser ground lease term where they are the lessor. It also acknowledges that, for public agencies, there may be some unforeseen legal impediments to certain of the requirements, and wishes to preserve the flexibility to address these circumstances. Without deviating further from its initial proposal, HCD is confident that the supply of high-quality projects able to comply with these requirements will be sufficient to fully exhaust the available program resources.

<u>Global Comments (not linked to specific sections of the proposed regulations)</u>

Comment: HCD regulates too much, making it difficult for sponsors to effectively manage their projects. It should adopt an approach more like TCAC's, setting a few key performance standards and not attempting detailed regulation.

Commenter number 25 made this comment, which was supported by **commenter number 1**.

Response: No change is proposed in response to this comment.

Discussion: This is best discussed in the context of specific issues.

Comment: HCD "controls" all units in a development, even if funding only a few.

Commenter number 25 made this comment.

Response: No change is proposed in response to this comment.

Discussion: This is best discussed in the context of specific issues.

Comment: Rules should match TCAC's as much as possible.

Commenter numbers 2, 26, 29 and 32 made this comment.

Response: No change is proposed in response to this comment.

Discussion: Many provisions of the initially regulations do match TCAC requirements. The changes described in this document generally bring them closer to these requirements.

Comment: Typically, HCD can safely rely on underwriting by other lenders and investors; no additional overlay is required.

Commenter number 32 made this comment.

Response: No change is proposed in response to this comment.

Discussion: HCD agrees that in many cases this is true; this is the reason why its underwriting is rarely as intensive as that of other funding sources. There are some areas, however, where HCD's interests are not protected by the underwriting of others. For example, tax credit investors plan to leave the project after about 15 years, and hence do not always give adequate attention to making sure that replacement reserves will suffice for 55 years.

<u>Other Comments (not linked to regulations)</u>

The Department appreciates the many other comments that were submitted relating to policies, procedures and practices that are not regulatory in nature and wants to assure the commenters that each comment is being reviewed and considered in our ongoing efforts to continually improve the delivery of our financial products.